

INTERIOR BOARD OF LAND APPEALS

Black Butte Coal Co.

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BLACK BUTTE COAL CO.

IBLA 96-563

Decided November 7, 1997

Appeal from a Decision by an Associate Director, Minerals Management Service, affirming an order requiring a restructured accounting and payment of additional coal royalty. MMS-93-0167-MIN.

Affirmed.

1. Coal Leases and Permits: Royalties

Payments made to a Federal coal lessee to continue options to buy 3.2 million tons of coal produced and delivered over a 5-year period were subject to royalty because the payments were part of the gross proceeds obtained by the lessee from coal production.

APPEARANCES: Joseph E. Jones, Esq., Omaha, Nebraska, for Black Butte Coal Company; Howard W. Chalker, Esq., Division of Energy and Resources, U.S. Department of the Interior, Washington, DC, for Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE ARNESS

Black Butte Coal Company (Black Butte) has appealed from a June 12, 1996, Decision of the Associate Director for Policy and Management Development, Minerals Management Service (MMS), affirming an order issued by MMS's Royalty Management Program (RMP) that required Black Butte to pay additional royalty and conduct a restructured accounting for transactions involving Federal coal leases numbered W-6266 and W-23411. The leases are located in Sweetwater County, near Point of Rocks, Wyoming, at the Black Butte Mine.

Between December 1986 and November 1991, 3.2 million tons of coal were produced from the leases and sold to Idaho Power Company (Idaho Power). On March 9, 1993, RMP assessed Black Butte \$155,452.44 additional royalty for payments made prior to delivery of the coal to Idaho Power. Coal delivery to Idaho Power was several times delayed; because of the delays, Idaho Power agreed to make additional payments not required by the original sales contract. The first such payment was made on December 20, 1981, and the last was made on November 12, 1985. It is those payments that MMS now seeks to impress with a royalty.

Black Butte labels the disputed payments "deferral payments;" MMS, however, says the payments "were clearly for [coal] production." (Answer at 8.) This conclusion is denied by Black Butte with the assertion that they "were specifically made for the nonproduction of coal." (Statement of Reasons (SOR) at 8.)

As Black Butte explains the origin of the disputed payments, in 1981, Black Butte agreed with Idaho Power to delay delivery of 3.2 million tons of coal in consideration of payments ranging from 13 to 15 percent of the contract price. (SOR at 3.) Under the 1981 agreement, Idaho Power agreed "to reimburse Black Butte for expenses incurred due to idle capacity at the mine resulting from Idaho [Power] not taking said deliveries." (SOR at 3; SOR Ex. 7, at 1.) A purpose of the deferral payments was also, however, to continue the contract to purchase so that "Idaho Power would agree to purchase all of the coal it was obligated to purchase and pay the full, escalated coal price when the coal was actually delivered." (SOR Ex. 1, at 4.) The agreement also provided that the payments "shall not be recoverable nor credited against any payments by Idaho [Power] for any subsequent deliveries of coal." (SOR at 3; SOR Ex. 7, at 2.)

In 1984, a further delay in delivery until May 1985 was agreed upon; the 1984 contract provided, in consideration of payments equal to 15 percent of each ton of delivered coal, that payments made to obtain future delivery "shall not reduce the price of coal, nor shall such payments be applied or credited against the price of coal or [Idaho Power's] payments under the 1981 agreement." (SOR at 4; SOR Ex. 8, at 10.) In 1986, Black Butte agreed to a new coal purchase contract with Idaho Power and Sierra Pacific Power Company, (SOR Ex. 9); this contract contained similar payment provisions. (SOR at 4; Reply at 3.) These agreements, Black Butte argues, support a conclusion that royalty may not be charged to payments that "could not be credited or recouped against the price of coal under a subsequent contract." (Reply at 4.) This conclusion is said to be consistent with prior MMS decisions in cases decided by the Department, and relies on Diamond Shamrock Exploration Co. v. Hodel (Diamond Shamrock), 853 F.2d 1159 (5th Cir. 1988), said to be controlling authority here. Further reliance is placed by Black Butte on Independent Petroleum Association of America v. Babbitt (IPAA), 92 F.3d 1248 (Fed. Cir. 1996), like Diamond Shamrock a case deciding a royalty dispute by construing a "take-or-pay" clause in a gas contract.

Finally, Black Butte asserts that MMS is barred from assessment of royalty by the limitation imposed by 28 U.S.C. § 2415(a) (1994) on contract actions, because more than 6 years were allowed to pass before royalty was assessed on the disputed payments. This argument can be summarily decided; it has been uniformly rejected because limitations imposed upon judicial enforcement do not apply to administrative actions pending before the Department. See, generally, Marathon Oil Co., 119 IBLA 345, 352 (1991), and authorities cited therein.

The take-or-pay cases cited by Black Butte arose in gas leasing royalty disputes. The "take-or-pay" proviso comes into play when a pipeline takes less gas annually from a producer than promised; if that happens, the pipeline is required to pay the difference between a minimum volume set by contract and the actual amount taken. Should the pipeline later take gas previously covered by a take-or-pay payment, it might become eligible under the take-and-pay clause for a credit for "make-up-gas." See Diamond Shamrock, 853 F.2d at 1164. The Diamond Shamrock court decided that take-or-pay payments "made before gas is actually produced and taken simply cannot be a payment for sale of gas." Id. at 1167. Finding such payments are "payment for the pipeline-purchaser's failure to purchase (take) gas," it was concluded that no "royalty is due on take-or-pay payments unless and until gas is actually produced and taken." Id. at 1167, 1168.

The IPAA decision goes further into the etiology of the take-or-pay provision, describing it as symptomatic of a "fundamental change in the natural gas industry" brought about by the transformation of gas pipelines from "merchants" into "common carriers." IPAA, 92 F.3d at 1251. As described by IPAA, take-or-pay settlement payments break down into two types: "buydowns" (payments in exchange for a new or amended contract), and "buyouts" (purchase of a release from a contract), although some contract settlements seem to involve aspects of both types. Id. at 1252. This distinction is seen to be important by the IPAA opinion because, while negotiations between the seller and buyer cannot change the nature of payments made for royalty purposes, if credit against delivered gas is later given for take-or-pay payments it then becomes subject to royalty. Id. at 1260. The court concluded that neither type of take-or-pay settlement was subject to royalty "unless and until they are credited toward the purchase of make-up gas." Id. at 1260.

Quite obviously, the take-or-pay cases provide little guidance for this appeal since they arise from complex contract relationships between gas producers and the pipelines they use for gas sales and distribution that find little in common with this coal transaction. The cited cases do, however, illustrate the general proposition that royalty collection by the Department depends on a link between lease production and money paid to a Federal lessee who produces a commodity subject to royalty. In the instant coal case, Black Butte and MMS agree that, under MMS regulations, royalty can only be assessed on receipts associated with coal production from the Federal leases. The Decision here under review found that the disputed payments were part of the total consideration paid for 3.2 million tons of Federal coal produced and sold to Idaho Power. This appeal poses the question whether that finding was correct.

The Federal leases from which coal was sold by Black Butte to Idaho Power each provide for payment of a production royalty; Lease W-6266 provides, at section 5, that "production royalty for Coal produced \* \* \* shall be 10 percent of the gross value of the coal produced [subject to a payment floor]." Section 6 of Lease W-23411 is similar, except that it

refers to Departmental regulations at 30 C.F.R. Part 211 (1982). Under Departmental regulation 30 C.F.R. § 211.63(a) (1982), coal royalty is assessed on "the gross value at the point of sale." The 1982 rule defines gross value as "the sale or contract unit price times the number of units sold," adjusted, as necessary, to reflect "the actual gross value of the coal." 30 C.F.R. § 211.63(b) (1982). Since 1976, the Department has adhered to a general rule, known as the "gross proceeds rule," which requires that gross value be "equal to the gross proceeds accruing to the lessee in payments for the produced coal." See Meadowlark, Inc., 133 IBLA 5, 16 (1995), appealed sub nom. Amax Land Co. v. Babbitt, Civ. No. 1-95-CV-02150 (D.D.C. Nov. 20, 1995), quoting from MMS rulemaking at 55 Fed. Reg. 35431 (Aug. 30, 1990). Gross value, as defined by Departmental regulations, includes all payments for coal production. Meadowlark, Inc., supra. This rule is properly applied here. See 30 C.F.R. § 206.257(b)(1).

[1] The contention by Black Butte that there is no connection between the so-called deferral payments and coal production does not bear scrutiny. The agreement to make deferral payments dated December 10, 1981, provides that, in consideration of the payments to be made, "all referenced agreements shall remain in full force and effect." (SOR Ex. 7, at 3.) The "referenced agreements" include the coal purchase agreement for 3.2 million tons of coal delivered between 1986 and 1991. As Black Butte argues, the price of the coal delivered under the sales contract was not reduced by the deferral payments, and those payments were not later credited against coal sold in 1986. Nonetheless, the contract with Idaho Power was to buy 3.2 million tons of coal under a delivery schedule that, as changed, was ultimately fulfilled. Contracts made since 1974 between the coal supplier and the power companies demonstrate, as the 1974 contract states, their purpose was to obtain "an assured and dependable source of coal." See SOR Ex. 4, at 1.

The 1984 agreement between Black Butte and Idaho Power explains that because of changed circumstances in Idaho Power's business, "greater scheduling flexibility" is needed. (SOR Ex. 8, at 2.) The 1984 agreement again extends an option to buy 3.2 million tons of coal in exchange for additional compensation. Id. If an analogy were to be drawn to the take-or-pay cases, this would be a buydown rather than a buyout agreement, but actually it is neither; it is an extension of an earlier option to buy, previously amended, that contemplates delivery of a specific quantity of coal over an extended period. This supply arrangement is not analogous to gas industry practices that led to the take-or-pay contract provision construed in Diamond Shamrock and IPAA; Idaho Power has not paid for something analogous to what was called the "failure to purchase (take)," described in Diamond Shamrock. Instead, Idaho Power paid to secure future delivery of 3.2 million tons of coal. Thereby, the disputed payments were directly linked to coal produced from the Federal leases, and became subject to payment of royalty when the coal so ordered was produced. See 30 C.F.R. § 206.257(b)(1).

Black Butte and Idaho Power did, as the SOR and Reply point out, label their payments differently, suggesting the purpose of their agreement was to obtain what they called "idle capacity." Although sometimes using the words "option" or "option agreement" or "required deliveries," language indicating that future coal delivery was the object of their bargain, the contracts also describe the disputed payments as "deferral charges." The nomenclature used by the bargaining parties is not, however, determinative of the effect of their agreement; when evaluating agreements between commodity users, the Department is not bound by the way the parties may characterize their payments, but must look to the substance of their agreement to determine whether royalty will be charged against payments. See Kerr McGee Oil Industries, Inc., 70 Interior Dec. 464, 469-70 (1963), a decision rejecting an argument that the Department was bound by a royalty valuation agreed upon by a buyer and seller of gas. In this case also, the Department is not bound by labeling attached by the buyer and seller to payments for scheduled coal deliveries.

It is concluded that payments made by Idaho Power to Black Butte beginning in December 1981 were advance payments for coal to be taken at a later date, and that Black Butte agreed to accept those payments in return for postponing the delivery date of the coal sold to Idaho Power according to an agreed schedule that was extended several times. The payments made between 1981 and 1985 formed part of the gross proceeds received by Black Butte for 3.2 million tons of coal produced and delivered under contract with Idaho Power between 1986 and 1991, and became subject to royalty charges when the coal was produced. See 30 C.F.R. § 211.63(b) (1982).

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 C.F.R. § 4.1, the Decision appealed from is affirmed.

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Franklin D. Amess  
Administrative Judge

I concur:

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James P. Terry  
Administrative Judge